

VZCZCXRO7355

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RUEHLZ RUEHPOD RUEHROV RUEHSR RUEHVK RUEHYG
DE RUEHVI #0940/01 1831546
ZNR UUUUU ZZH
R 011546Z JUL 08
FM AMEMBASSY VIENNA
TO RUEHC/SECSTATE WASHDC 0479
INFO RUEHZL/EUROPEAN POLITICAL COLLECTIVE

UNCLAS SECTION 01 OF 02 VIENNA 000940

SIPDIS

E.O. 12958: N/A

TAGS: [ECON](#) [EFIN](#) [PGOV](#)

SUBJECT: LEADERS USE AUSTRIAN ECONOMIC REPORT TO REVIEW
DIVERGENT AGENDAS

¶1. Summary: At the June 30th presentation of the annual Austrian Economic Report, Minister of Economics and Labor Bartenstein and Vice Chancellor and Finance Minister Molterer, both members of the Austrian People's Party (OeVP), presented an optimistic view of the Austrian economy, highlighting strong growth and emphasizing Austria's economic advantages derived from globalization and the expansion of the European Union. In contrast, Social Democratic Party (SPOe) Chancellor Gusenbauer, spoke on a more somber note about challenges facing Austria including inflation, global competition, and economic inequality. The contrast between the two parties reflects a growing public divide between them, particularly on privatization, tax reform, and European integration. Molterer's pointed emphasis that Austria was one of the "winners" from European integration and globalization was directed at the SPOe decision to put any future EU treaties to a popular vote, a sharp departure from the SPOe's previous position. The signs of increased tension evident in Monday's event are widely taken as evidence an early election is increasingly likely. End Summary.

¶2. The nominal purpose of the annual Austrian Economic Report is to review Austria's economic performance over the past year and its future prospects. The speakers agreed on many areas of strength, such as strong export growth and a lower than expected government budget deficit of 0.6%, as well as on several challenges facing the economy, including inflation, controlling government spending, tax reform, and the need to improve national competitiveness.

¶3. Economics Minister Bartenstein focused on the country's successful economic performance over the past year, citing strong GDP growth of 3.4% that exceeded the Euro zone average of 2.6%. Austria had maintained its position as the fourth wealthiest land in the EU in GDP per capita, behind Luxemburg, Ireland, and the Netherlands, though the government had hoped to move Austria into third place, which also did not look likely for the next year as GDP growth in 2008 was expected to slow to 2.2%. Growth in 2007 was led by a 10% expansion in exports, with particularly strong growth in exports to Eastern Europe (17% over the previous year). Outward Foreign Direct Investment (FDI) reached a record high of 23.3 Million Euro, with 41% of investment directed toward Eastern Europe; Croatia, Turkey, and Russia were the largest recipients. Inward FDI also reached a record level of 22.4 Million Euro, with the largest sources being Italy, the Netherlands, and the U.S. Both exports and FDI (inward and outward) were expected to slow in the next year due to rising inflation, high oil prices, weak consumption, and slower economic growth in Austria's primary export markets and target investment countries.

¶4. Bartenstein noted several overarching challenges to the Austrian economy. Inflation rose from 2.2% in 2006 to 3.5% in 2007, the highest level since 1993. While inflation was projected to drop to 2.7% in 2009 (assuming that commodity prices wouldn't continue their abrupt rise and that a

wage-price spiral could be prevented), addressing inflation has become a priority. The GOA had begun monitoring energy and food prices more closely, and would expand measures to increase competition. Bartenstein cited a lack of skilled labor, particularly in critical professions like engineering, as another problem area, and called for increased spending on education and workforce training, a call echoed by both Molterer and Gusenbauer. Finally, Bartenstein emphasized the need to implement sustainable employment policies to reduce the burden on the national pension system. He cited the success in the past year of increasing employment for workers aged 55 to 64 from 30% to 40%, which brought Austria in line with the European average, but he emphasized the need to continue to find ways to discourage early retirement.

15. Molterer began his remarks emphasizing that Austria had been one of the biggest beneficiaries of globalization and European integration - the only line from any of the speakers to provoke applause from an audience heavily represented by the business community. Outside pressure from the EU forced Austria to implement necessary structural reforms, and businesses in Austria had leveraged EU expansion better than anywhere else in Europe. Molterer's praise of the EU was a direct response to Gusenbauer's criticism of the EU, which appeared in the mass circulation tabloid Kronen Zeitung last Friday, and his decision to reverse previous SPOe opposition to national referenda on EU treaties (septel). Molterer's remarks about privatization and fiscal policy also contradicted positions later advocated by Gusenbauer. Molterer emphasized the need to enforce a strict "no-debt" policy for government spending, and he cited necessary reforms like simplifying the tax system to reduce the burden on families and social welfare programs. He also pointed to

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privatization of state-owned enterprises as a way to decrease government debt and finance the welfare system. Finally, Molterer complained that the environment for reform in Austria had considerably worsened, indicative of the current stand-still in reform as well as increasing tensions within the current coalition government.

16. Chancellor Gusenbauer focused on the challenges facing the Austrian economy, citing slower global growth, the U.S. mortgage crisis and its after effects, higher inflation, and rising income inequality. He spoke at length about what he perceived to be growing fears of income erosion and increasing skepticism with Austria's current economic trajectory, a reference to growing dissatisfaction with European integration - the closest Gusenbauer came to addressing his comments in the Kronen Zeitung last week. Gusenbauer also emphasized the need for strategic investments in innovation in areas such as research and development, education, infrastructure, and climate change. His calls to increase spending for social welfare coverage conflicted with Molterer's emphasis on fiscal restraint. Gusenbauer also rejected Molterer's plans for privatization, stating that revenue from state owned enterprises was necessary to finance the welfare fund (in contrast to Molterer and the OeVP, which propose an increase in estate taxes).

17. Comment. Many observers saw in the event both signs of growing tension within the government - Gusenbauer and his conservative ministers even avoided looking at one another - and a foretaste of the economic themes the two parties would use should early elections be called.

Kilner